

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Cedillo Analyst: Roger Lackey Bill Number: AB 166  
Related Bills: See Legislative History Telephone: 845-3627 Introduced Date: 02-05-2001  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Rehabilitation Of Historic Building Credit

### SUMMARY

This bill would:

- allow a credit based on the federal rehabilitation credit, and
- increase from 20% to 25% the credit for rehabilitation of historical structures in redevelopment areas.

### PURPOSE OF THE BILL

The author's staff has indicated that the author's intent is to provide a credit identical to the federal rehabilitation credit.

### EFFECTIVE/OPERATIVE DATE

This bill would be effective immediately as a tax levy, and would apply to taxable years beginning on or after January 1, 2001, and before January 1, 2011.

### POSITION

Pending.

#### Summary of Suggested Amendments

The attached amendments have been included at the request of the author's staff to resolve the implementation considerations discussed below.

### ANALYSIS

#### FEDERAL/STATE LAW

**Existing federal law** provides a rehabilitation credit in the following amounts:

1. A credit equal to 10% of the qualified rehabilitation expenditures with respect to any qualified rehabilitated building other than a certified historic structure; and

Board Position:

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Department Director

Date

Alan Hunter for GHG

04/04/01

2. A credit equal to 20% of the qualified rehabilitation expenditures with respect to any certified historic structure.

"Qualified rehabilitated building" means any building placed in service prior to 1936 that has been substantially rehabilitated. During the rehabilitation process the building must have 50% or more of the existing external walls retained as external walls, 75% of the external walls must be retained as internal or external walls, and 75% of the existing internal structural framework must remain in place.

"Certified historic structure" means any building listed in the National Register or is located in a registered historic district and certified by the Secretary of the Interior as being of historic significance to the district.

"Qualified rehabilitation expenditures" means any amount properly chargeable to a capital account for depreciable property in connection with the rehabilitation of a qualified rehabilitation building. Qualified rehabilitation expenditures do not include any expenditure that is not depreciated using the straight-line method, the cost of acquisition of the building or interest, and enlargements.

The federal rehabilitation credit is allowed as a component of the investment credit, which is part of the general business credit. Special rules provide for recapture of all or a portion of the federal credit if the investment credit property (including any property eligible for the rehabilitation credit) is disposed of or otherwise ceases to be investment credit property with respect to the taxpayer prior to the end of the recapture period. In general, the recapture period ends 5 years after the date the investment credit property is placed in service. In addition, the basis of rehabilitation credit property must be reduced by the amount of the rehabilitation credit.

Federal law provides a one-year carryback and a 20-year carryforward period for unused general business credits, including the rehabilitation credit. If the credit is unused after the expiration of the carryover period, the taxpayer is allowed to deduct the unused portion of the credit.

Existing **state law** does not allow a credit related to rehabilitation of property or historical buildings. Credits may not be carried back and no provision allows an unused credit to be deducted.

### THIS BILL

This bill would allow a credit in an amount determined in accordance with provisions of the federal rehabilitation credit. However, this bill also would allow a 25% credit for any certified rehabilitation of a certified historic structure within a redevelopment area. The federal limitations applicable to the rehabilitation credit as an investment credit or a business credit would not be applicable to the credit provided by the bill.

Any unused credit could be carried over until exhausted.

### IMPLEMENTATION CONSIDERATIONS

This bill would allow a taxpayer that completes the certified rehabilitation of a certified historic structure in a redevelopment area a credit equal to 25% of those costs. However, the term "redevelopment area" is not defined. Amendments 1 and 5 would clarify that a "redevelopment area" means a geographical area that has been designated by the local redevelopment agency.

This bill does not limit the credit to property located within this state. As a result, the credit would be allowed to a taxpayer that is rehabilitating a qualified rehabilitated building or historical structure located in another state. Amendments 2 and 6 would limit the credit to buildings located within California.

Generally, in calculating a credit, the credit is reduced by any similar federal credits that may be received for the same expenditures. Amendments 2 and 6 would add language reducing the expenditures used in calculating the credit by the amount of the federal rehabilitation credit.

Generally, credits do not allow a deduction for the same expenditures used to create the credit. Amendments 2 and 6 disallow any deduction for which a credit is allowed.

This bill does not limit the number of years for the carryover. The department would be required to retain the carryover on the tax forms indefinitely because unlimited credit carryover is allowed. Recent credits have been enacted with a carryover limit since departmental experience shows credits typically are exhausted within eight years of being earned. Amendments 3 and 7 would add an eight-year carryover limit.

## **LEGISLATIVE HISTORY**

SB 875 (Marks, 1995/1996) would have allowed a credit for an amount equal to 10% of the costs for rehabilitating a residential historic building, and 20% of the costs for rehabilitating a commercial historic building. This bill failed to pass the Assembly Revenue and Taxation Committee.

## **OTHER STATES' INFORMATION**

The tax laws of Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York were reviewed because of their similarity to the tax laws of California.

**Michigan** income tax law allows a 25% rehabilitation credit for qualified expenditures. The credit is based on the federal eligibility requirements.

**New York** provides two similar rehabilitation credits. The first credit is a historic barn rehabilitation credit equal to 25% of the qualified expenditures. The second credit is for retail businesses that rehabilitate qualified buildings. The credit applies only against the portion of the building used in retail activity. Both credits require the building be located in New York.

The states of Florida, Illinois, and Minnesota have no credits similar to the rehabilitation credit proposed by this bill.

## **FISCAL IMPACT**

This bill would not significantly impact departmental costs.

## ECONOMIC IMPACT

### Tax Revenue Estimate

This bill is estimated to impact Personal Income Tax and Bank and Corporation Tax revenues as shown in the following table:

Fiscal Year Cash Flow		
Taxable Years Beginning After December 31, 2000		
Enactment Assumed After June 30, 2001		
\$ Millions		
2001-02	2002-03	2003-04
-\$2	-\$3	-\$3

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

**Note:** This bill, as currently drafted, does not specify the exact definition of a redevelopment area for buildings that would qualify. Therefore, the revenue impact above assumes that the vast majority of historical structures located in California could potentially qualify, but does not assume that buildings located in other states that are owned by taxpayers subject to California tax would qualify.

### Tax Revenue Discussion

The revenue impact for this bill will be determined by the number of qualifying buildings, the cost of rehabilitation, and the amount of credits that can be applied against available tax liabilities.

Revenue estimates above were based on federal projections for this provision. The impact attributed to California was based on state-to-nation comparisons of pre-1940 structures and adjusted for California's lower tax rates and the 25% credit allowed in the bill.

## ARGUMENTS/POLICY CONCERNS

This bill would create a state rehabilitation credit equal to the credit amount allowed under federal law. State credits based on federal law typically have reduced percentages, as the taxpayer's state tax liability is generally proportionately smaller than federal tax liability.

## LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 166  
As Introduced February 5, 2001

AMENDMENT 1

On page 2, line 8, after "redevelopment area." insert:

For purposes of this section, "redevelopment area" means a geographical area within this state that has been designated by the local redevelopment agency per Part 1 (commencing with Section 33000) Division 24 of the Health and Safety Code, as such.

AMENDMENT 2

On page 2, line 9, after "(b)" insert:

The credit provided by this section shall only apply to expenditures with respect to a qualified rehabilitated building located within this state.

(c) No deduction shall be allowed under this part for any cost for which a credit is allowed by this section.

(d) If a credit is determined under this section with respect to any property, the basis of such property shall be reduced by the amount of the credit determined.

(e)

AMENDMENT 3

On page 2, line 11, after "and" insert:

the seven

AMENDMENT 4

On page 2, line 13, strikeout "(c)" and insert:

(f)

AMENDMENT 5

On page 2, line 24, after "redevelopment area." insert:

For purposes of this section, "redevelopment area" means a geographical area within this state that has been designated by the local redevelopment agency per Part 1 (commencing with Section 33000) Division 24 of the Health and Safety Code, as such.

AMENDMENT 6

On page 2, line 25, after "(b)" insert:

The credit provided by this section shall only apply to property located within this state.

(c) No deduction shall be allowed under this part for any cost for which a credit is allowed by this section.

(d) If a credit is determined under this section with respect to any property, the basis of such property shall be reduced by the amount of the credit determined.

(e)

AMENDMENT 7

On page 2, line 27, after "and" insert:

the seven

AMENDMENT 8

On page 2, line 29, strikeout "(c)" and insert:

(f)